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Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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A New Fiscal Year . . .

Despite the appearance of several welcome signs suggesting that the economy may be poised to rebound from the longest and deepest economic slump of the postwar era, one area of consistently bleak news persists. This is the outlook for Federal finances. Any hopes of a substantial midterm correction in the course of the Administration's economic policy were dashed at the end of January with the presentation of the fiscal 1984 budget message.

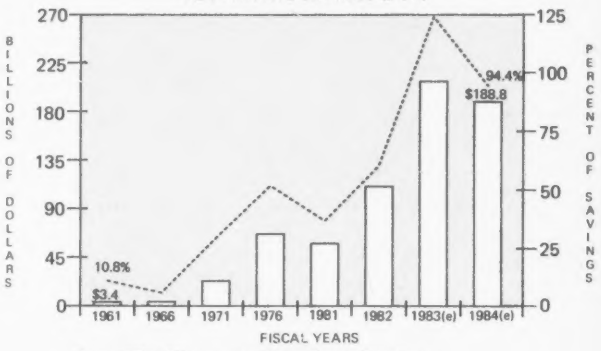
Notwithstanding the proposed inflation-adjusted spending freeze and standby tax increase, the broad outlines of the fiscal 1984 budget are much the same as those of its 1982 and 1983 predecessors: It contains deep cuts in "real" nondefense spending, sizable increases in military outlays and the implementation of another phase of the tax cuts legislated in the Economic Recovery Tax Act of 1981. The result of this budget is likely to be much the same. There will be towering deficits and soaring Treasury borrowings, absorbing near record proportions of net private savings and accounting for the lion's share of total funds raised in the financial markets.

To be sure, there is one difference. The reception accorded this budget message in both Congress and the credit markets has been somewhat more favorable than that of its predecessors, which were largely dismissed out of hand due to unrealistic economic assumptions and subsequent revenue, spending and deficit projections. This time around, the Administration projected precisely the opposite. It used extremely cautious economic assumptions which may turn out to overestimate Washington's projected red ink totals. Whereas the Federal deficit is now projected to be anywhere from $117 billion to $300 billion in the red by fiscal 1988 using the Administration's real growth estimates of 1.4 per cent this year and approximately four per cent thereafter, if real economic growth were to average just 1-1/3 percentage points higher per year, it would yield a balanced Federal budget by fiscal year 1988!

. . . Plus A New Federal Budget . . .

These widely varying deficit estimates clearly point to the imprecision of the budget preparation process. Just a one percentage point change in the rate of unemployment, for example, results in an approximately $25 billion swing in the overall budget deficit. But this raises the question as to

FEDERAL BUDGET DEFICIT (BAR) VS.
FEDERAL BUDGET DEFICIT AS A PERCENT OF
NET PRIVATE SAVINGS (DOT)



Source: Office of Management and Budget, Treasury Department

whether or not the private sector can stage a sufficiently vigorous recovery to narrow the budget deficit substantially—especially in light of the size of the deficits now expected, and their impact on inflation expectations and interest rates. And here, the outlook is not that bright. For as shown in the chart above, the Administration itself now estimates that the Treasury deficit alone will absorb a sizable 94 per cent of net private savings in fiscal 1984 which, although lower than the estimated 124 per cent level of fiscal year 1983, is still more than nine times the proportion of net private savings absorbed in the early 1960s. What this suggests is that once recovery does get underway and private credit demands do begin to revive, higher interest rates and a short-lived recovery will result unless the Federal Reserve continues to ease money.

Indeed, cyclical factors alone cannot possibly reduce Washington's borrowing needs in time to avoid the financial market strains that would develop in early

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1984 were there to be an abrupt shift in monetary policy back toward tightness. Perhaps the most important reason is that time is too short. The anticipated fiscal 1984 deficit would have to be shaved by $85 billion (or 45 per cent) simply to lower the proportion of net private savings absorbed by the Federal deficit back to fiscal 1976 levels—when it stood at the already lofty, 50 per cent level. And, with less than nine months remaining until fiscal 1984 commences, such a reduction in the deficit's size is quite unlikely.

. . . Equals The Same Old News . . .

Instead of relying on an economic upswing to reduce the deficit, the government might want to examine other means of enhancing revenues while at the same time reducing spending. On the revenue side, there is substantial room for improvement. Receipts are now expected to cover only $3 of every $4 actually spent next fiscal year, and while it is true that the combination of slow personal incomes growth, double-digit rates of unemployment and weak corporate profits growth have dampened revenue growth, so, too, have the Administration's own actions.

According to the Office of Management and Budget, the tax cuts legislated in 1981 are ". . . estimated to reduce receipts by $38.3 billion in 1982, $91.6 billion in 1983, $139 billion in 1984, and $176.7

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 1/26/83	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	142.983	– 2.458	+ 7.737
Loans to Depository Inst.	.328	– .139	– 2.141
Float	2.598	+ .665	– .971
Total Reserve Bank Credit	155.992	– 2.163	+ 4.906
Treasury Deposits with Federal Reserve Banks	3.909	+ .794	– 2.238
Currency Outside Banks	133.436	– 1.295	+ 9.813
Member Bank Reserves:			
Required	41.041	– 1.460	– 1.663
Excess (Deficiency)	.553	– .120	+ .356
Total Reserves Held	41.594	– 1.580	– 1.307
Net Free Reserves	.456	+ .107	+ 2.433
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	111.362	+ 1.147	+15.829

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	485.9	+ 12.6‡	+ 7.6‡
M2 (December '82)	1,999.2	+ 9.0	+ 9.7
M3 (December '82)	2,403.8	+ 6.7	+ 9.9
L (September '82)	2,866.2	+ 9.5	+ 11.2

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 2/4/83	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.75%	7.90%	8.05%
* Federal Agencies	8.10	8.55	8.90
* Project Notes–Taxfree (46% Taxable Equivalent)	7.50	8.15	8.70
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.80	9.13	9.65

‡Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.50%	Mar.	8.40%
15- 29 days	8.50	Apr.	8.40
30- 59 days	8.50	May	8.50
60- 89 days	8.50	Jun.	8.60
90-179 days	8.63	Jul.	8.65
180-239 days	8.63	Aug.	8.60
240-270 days	8.63		

‡Industrial Paper–Prime			
30- 89 days	8.38%	†Federal Funds Effective Rate	8.35%
90-120 days	8.38		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'82	$ 3,101	$ 3,088	$ 3,003
Gross National Product (1972 Dollars)*	4th Q'82	$ 1,472	$ 1,481	$ 1,490
Percent Change, Annual Rate	4th Q'82	– 2.5	0.7	– 5.3
Change in Consumer Prices (all urban consumers)*	Dec '82	– 3.6%	1.2%	4.8%
Change in Producer Prices*	Dec '82	1.2%	7.2%	3.6%
Civilian Employment (Thousands of Persons)†	Jan '83n	99,103	99,093	99,688
Unemployment as % of Civilian Labor Force†	Jan '83n	10.4%	10.8%	8.6%
Personal Income*	Dec '82	$ 2,637	$ 2,621	$ 2,498
Leading Indicators Composite Index (1967=100)†	Dec '82	132.8	130.8	127.1
Industrial Production Index (1967=100) †	Dec '82	134.7	134.8	143.4
Net Change in Consumer Installment Credit†	Nov '82	$ 2.52	–$ 0.32	$ 0.60
U.S. Merchandise Trade Balance †	Dec '82	–$ 3.37	–$ 4.09	–$ 1.81
Plant and Equipment Expenditures*	1st Q'83	$316.40(a)	$324.47(a)	$327.72
Private Housing Starts (Thousands of Units)*	Dec '82	1,222	1,404	882
New Construction Expenditures*	Dec '82n	$ 239.0	$ 235.8	$ 228.8
Total Business Inventories†	Nov '82	$ 508.6	$ 514.2	$ 521.6
Total Business Sales†	Nov '82	$ 336.4	$ 332.5	$ 344.9

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

billion in 1985." Because of this development, the Administration has been back-pedaling ever since, engineering first a three-year, $99 billion tax increase package just last year and now proposing standby taxes on crude oil and surcharges on individual and corporate income taxes. These levies, if adopted, would net the Administration approximately $45 billion annually during the fiscal 1986-88 period, offsetting a good-sized chunk—but not all—of the revenue loss associated with the 1981 tax rate reductions.

But why wait until fiscal 1986, and run the risk of aborting this year's recovery in early 1984? A similar revenue impact could be achieved much sooner by simply delaying this July's scheduled reduction in personal income tax rates, which would boost receipts by perhaps $32 billion and shave the anticipated fiscal 1984 deficit by 17 per cent.

. . . Grim

On the spending side, past profligacy in nondefense spending, along with actual and proposed vast increases in defense spending continue to derail prospects for budget balance. In fiscal 1982, military spending once again became the engine of Federal spending growth, advancing by 17.3 per cent year-over-year (or twice the rate of rise in income security spending), accounting for almost 40 per cent of the $74 billion, overall expenditure

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (1/19/83)	119,939	– 4,515	–12,575
New York City (1/19/83)	32,444	– 1,255	– 226
Commercial Paper (1/19/83)	166,294	+ 1,011	+ 55*

*Series redefined: Data prior to December 1, 1982, are not strictly comparable to the data reported after that date.

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/19/83)	218,315	+ 1,050	+22,586
New York City (1/19/83)	61,359	+ 371	+ 5,892

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/19/83)	505,174	– 60	+35,224
New York City (1/19/83)	118,868	+ 612	+10,051

Financial Markets

	Friday 2/4/83	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.53%	+ .26	– 5.85
180-Day Bills†	8.82	+ .30	– 5.96
Longest Bills†	9.10	+ .28	– 5.63
Recent Issues:			
9¼s 1/31/85	9.80	+ .32	
10s 12/31/86	10.28	+ .24	
10⅞s 2/15/93 (When Issued)	10.98	NA	
10⅜s 11/15/12 (When Issued)	11.10	NA	
Municipals:			
Bond Buyer–20 Bond Index* (2/3/83)	9.74%	+ .08	– 3.39
Blue List Total ($ Million)	$ 835	– $254	– $ 12
30-Day Visible Supply ($ Million)	$1,926	+ $127	+ $356
Total	$2,761	– $127	+ $344
Corporates:			
Moody's Aa Composite (2/3/83)	12.65%	+ .17	– 3.15
30-Day Visible Supply ($ Million) ‡	$ 550	– $ 90	NA
Stocks:			
Dow-Jones Averages:			
Industrials	1,077.91	+ 13.16	+ 226.88
Transportation	485.07	+ 24.70	+ 127.90
Utilities	125.05	+ 1.43	+ 18.10
65 Stocks	428.43	+ 10.12	+ 93.40
Standard and Poor's 500 Stocks	146.14	+ 1.63	+ 28.88
N.Y.S.E. Composite Index	84.29	+ .94	+ 16.50
N.Y.S.E. Avg. Daily Vol. for Week (000's)	78,660	– 5,866	+ 28,792

* 46% Taxable equivalent 18.04%.
‡Series redefined: Historical data not available.
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/4/83	Week Ago
Overnight	8.38%	8.63%
1 month	9.00	9.00
3 month	9.31	9.25
6 month	9.63	9.38
1 year	10.00	9.75
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	11.90%	11.80%
Long Term (7 to 15 yrs.)	12.00	11.90

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/4/83)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02060	48.54
Canada	.8134	1.2294
Denmark	.1148	8.7100
France	.1422	7.0315
Germany	.4032	2.4800
Italy	.0007012	1426.00
Japan	.004165	240.08
Mexico	.006741	148.35
Netherlands	.3672	2.7235
Switzerland	.4919	2.0330
U.K.	1.5168	.6593

rise. Putting this together with the $19 billion increase in net interest costs brought the total increase in just these two items alone to $47 billion last fiscal year—accounting for almost $2 of every $3 incremental dollars spent.

Nor are these trends likely to be reversed anytime soon. In fact, they will get worse. As proposed, defense spending is slated to increase by an average of $35 billion annually throughout the fiscal 1984-88 period, while interest outlays are expected to soar by an additional $9 billion per annum.

Since overall Federal spending will increase by only $64 billion annually, the implications are clear—defense and debt service will account for 70 per cent of all additional Federal dollars spent from now until September, 1988. What is more, compared with anticipated revenue trends, the results are even more disturbing. If the standby tax proposals are implemented, these same increases in military and interest cost outlays would equal about 60 per cent of average annual revenue growth. If the tax proposals are not enacted, they just about equal average annual revenue growth! H

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